

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **200750016**

Release Date: 12/14/2007

CC:SB:PRESP-148314-05

UILC: 165.04-02

date: November 08, 2007

to: Acting Director
(SB/SE Exam Policy)

from: Special Counsel
(Small Business/Self-Employed)

subject: Gulf Disaster Casualty Losses and Government Grants

ISSUE: Treatment of Gulf Hurricane casualty loss claims involving reimbursement, or a reasonable expectation of reimbursement, for the loss from federal or State grants.

CONCLUSION: The same rule does not apply under the I.R.C. § 165 regulations to taxpayers claiming a casualty loss and to the IRS when it examines a claimed loss.

- Taxpayers must reduce their casualty loss deduction by the amount of any reimbursements received or by the amount of reasonably expected prospective reimbursements as determined by the end of the taxable year of the casualty. Taxpayers may also reduce their casualty loss deduction, if they wish, by the amount of any reasonably expected prospective reimbursements, determined as of the time of the filing of the tax return claiming the loss
- Examiners use the same criteria as the taxpayer, but must base their determination of the facts and circumstances as of the end of the tax year for which the casualty loss is claimed.

[REDACTED]
[REDACTED] the IRS may not reduce casualty losses claimed for 2005 to reflect receipt of a Road Home grant (or of any other reimbursement) during

2006 (or 2007), or to reflect an expectation of reimbursement from such grants or other sources arising after the taxable year end and by the time the return was filed or of the examination.

BACKGROUND:

In some cases, [REDACTED]

A problem arises because the same rule does not apply under the section 165 regulations to taxpayers claiming a casualty loss and to the IRS when it examines a claimed loss. Specifically, even though a taxpayer may not have had a reasonable expectation of reimbursement as of the end of the taxable year of the casualty loss, when such an expectation arises before the filing of the return on which the loss is claimed, the taxpayer may voluntarily reduce the amount of its casualty loss deduction to anticipate the reimbursement. To the extent that a taxpayer reduces the loss by the expected reimbursement, the taxpayer is not required to include that amount in income under the tax benefit rule of IRC § 111 in the later year that it is actually received.

The IRS, however, is limited under Treas. Reg. § 1.165-1(d)(2) to determining the amount of loss allowable under the facts existing as of the end of the tax year for which the loss is claimed (i.e., the tax year in which the loss occurred – not a carryback loss year). The IRS may not, therefore, reduce any 2005 disaster casualty loss (and any related 2004 loss carryback) to reflect reimbursements received in later years or potential reimbursements that taxpayers may reasonably expect or have expected at filing or during examination.

The timing of the facts on the Road Home grant programs is pertinent here. [REDACTED]

[REDACTED] because no Federal Community Development Block Grants (CDBG, or the Road Home Grant program) were approved until January 2006, when the Department of Housing and Urban Development (HUD) announced the first allocation of \$11.5 billion in CDBG funding for the five affected Gulf states.

The Mississippi Road Home program providing assistance to qualified affected homeowners was announced by HUD on April 4, 2006, and funds were not released for eventually distribution to Mississippi homeowners, until July 10, 2006. (Note that on January 24, 2007, HUD announced that 10,000 Mississippi homeowners had already received their Mississippi Road Home grants.) HUD announced approval and authorization of Louisiana's CDBG Road Home Grant Program on May 30, 2006. Different authorizations dates in 2006 apply to programs in Alabama, Texas and Florida, and in some cases also to grants for businesses in the various states. Although funds were also relatively promptly released to Louisiana, there have been significant problems with notification of citizens that they qualify under the Louisiana program and with disbursement of Louisiana grant funds. The announcement of the State of Louisiana's action plan for its Road Home program to homeowners who suffered flood and/or wind damage to their residences from Hurricanes Katrina and/or Rita did not take place until December 6, 2006. On March 15, 2007, HUD informed Louisiana that it was out of compliance with the program.

This advice has been coordinated with Tom Moffitt, Branch Chief, Office of the Associate Chief Counsel, Income Tax and Accounting.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Jan Geier at (202) 283-7661 if you have any further questions.